

**Before the
Federal Communications Commission
Washington, D.C. 20554**

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|---|---|---------------------|
| In the Matter of |) | |
| |) | |
| Amendment of Part 1 of the Commission's Rules – |) | |
| Competitive Bidding Procedures |) | WT Docket No. 97-82 |
| |) | |
| |) | |

EIGHTH REPORT AND ORDER

Adopted: February 8, 2002

Released: February 13, 2002

By the Commission:

I. INTRODUCTION

1. In this order, we address the proposals and tentative conclusions of the *Part 1 Fourth Further Notice of Proposed Rule Making* (“*Further Notice*”).¹ In the *Further Notice*, the Commission sought comment on whether to incorporate a total assets component into its ownership attribution rule for determining which entities are eligible for small business provisions in competitive bidding proceedings.²

The Commission also proposed three exceptions to the requirement in its competitive bidding attribution rule that certain ownership interests be counted on a “fully diluted” basis.³ For the reasons explained below, we decline to adopt a total assets test as part of our determination of small business eligibility; however, we adopt two of the proposed exceptions to the attribution rule and clarify the Commission’s rules regarding the third.

¹ Amendment of Part 1 of the Commission’s Rules – Competitive Bidding Procedures, WT Docket No. 97-82, *Order on Reconsideration of the Third Report and Order, Fifth Report and Order, and Fourth Further Notice of Proposed Rule Making* (in relevant part, “*Part 1 Fifth Report and Order*” and “*Part 1 Fourth Further Notice of Proposed Rule Making*” or “*Further Notice*”), 15 FCC Rcd 15,293, 15,331-34, ¶¶ 79-88 (2000).

² See *Further Notice*, 15 FCC Rcd 15,331-32, ¶¶ 80-81. See 47 C.F.R. § 1.2110(b)(1) (“The gross revenues of the applicant (or licensee), its controlling interests and their affiliates shall be attributed to the applicant and considered on a cumulative basis and aggregated for purposes of determining whether the applicant (or licensee) is eligible for status as a small business under this section.”) See also *id.* § 1.2110(c)(1) (“Small businesses. The Commission will establish the definition of a small business on a service-specific basis, taking into consideration the characteristics and capital requirements of the particular service.”)

³ *Id.*, 15 FCC Rcd 15,332-34, ¶¶ 82-88. The Commission received four comments and no oppositions or replies in response to the *Further Notice*. Appendix B contains a list of full and abbreviated names of the commenting parties.

II. TOTAL ASSETS TEST

A. Background

2. Historically, the Commission has defined small businesses according to a gross revenues test for purposes of ascertaining eligibility for a small business bidding credit.⁴ In the *Part 1 Third Report and Order*, the Commission adopted a gross revenues test as its general standard for measuring the size of an entity for competitive bidding purposes, in part because such a standard provides “an accurate, equitable, and easily ascertainable measure of business size.”⁵ In conjunction with a gross revenues test, we currently employ a total assets test to evaluate the eligibility of applicants to acquire broadband Personal Communications Services (PCS) C and F block licenses made available in “closed” (entrepreneur-only) bidding.⁶ In the *Further Notice*, the Commission sought comment on whether the use of a total assets test, in conjunction with the gross revenues measure already employed, would enhance Commission determinations of small business status.⁷

B. Discussion

3. We decline to expand our definition of small business to include a total assets test for purposes of determining small business bidding credit eligibility. Commenters favoring the inclusion of a total assets test suggest that it could serve to prevent low-revenue but asset-rich businesses from taking advantage of small business programs.⁸ However, others argue that a total assets test might disqualify small entities by setting an asset limit that is too low or by attributing assets that are not readily available to these entities for auction purposes.⁹ Our attribution rules already prevent many asset-rich applicants from taking advantage of our small business benefits, because, to the extent that their assets, or those of their controlling interests and affiliates, produce revenues, those revenues must be attributed to the applicant.¹⁰ Moreover, the Commission’s experience in using a total assets test to determine C and F block entrepreneur eligibility indicates that the test adds complexity to business size determinations without producing a commensurate benefit. In broadband PCS Auctions No. 5, 10, 11, and 22, in which all C and F block bidders were required to meet a total assets test as well as a gross revenues test to

⁴ Amendment of Part 1 of the Commission’s Rules – Competitive Bidding Proceeding, WT Docket No. 97-82, *Order, Memorandum Opinion and Order and Notice of Proposed Rule Making*, 12 FCC Rcd 5686, 5699, ¶ 19 (1997) (“*Part 1 Notice of Proposed Rule Making*”).

⁵ Amendment of Part 1 of the Commission’s Rules – Competitive Bidding Procedures, Allocation of Spectrum Below 5 GHz Transferred from Federal Government Use, 4660-4685 MHz, WT Docket No. 97-82, ET Docket No. 94-32, *Third Report and Order and Second Further Notice of Proposed Rule Making*, 13 FCC Rcd 374, 388-89, ¶ 19 (1997) (“*Part 1 Third Report and Order*”).

⁶ See 47 C.F.R. § 24.709(a). The Commission uses only a gross revenues test to determine small business bidding credit eligibility in C and F block auctions. See *id.* §§ 24.712, 24.717, 24.720(b).

⁷ *Further Notice*, 15 FCC Rcd 15,293, 15,331-32, ¶ 81.

⁸ See NTCA Comments at 1-3, RTG Comments at 4-5, and SBA Comments at 2.

⁹ See Joint Commenters Comments at 3.

¹⁰ See 47 C.F.R. § 1.2110(b),(c).

establish entrepreneur eligibility,¹¹ more than 95 percent of those bidders also met the more stringent gross revenues test required for small business bidding credit eligibility.¹² Thus, in practice, having a total assets test for the C and F blocks has not made a significant difference in defining the qualified applicant population. At the same time, employing a total assets test carries administrative costs for the Commission and for applicants and raises difficult valuation issues. As the Commission observed in its decision not to establish a total assets test for Local Multipoint Distribution Service business size determinations, “[a]ssets, being potentially fluid and subject to inconsistent valuation (e.g., intangibles) are generally much less ascertainable than gross revenues”¹³ We believe that the potential benefit provided by a total assets test does not outweigh the valuation difficulties and the administrative costs the test would impose. Moreover, we are reluctant to impose an additional regulatory burden on auction applicants at a time when we are striving to streamline Commission processes.¹⁴ For these reasons, we will not implement a total assets test for small business eligibility determinations.

III. ATTRIBUTION ISSUES

A. Rights of First Refusal and Put Options

1. Background.

4. In the *Part 1 Fifth Report and Order*, the Commission adopted the controlling interest

¹¹ An applicant for C and F block licenses in Auctions No. 5, 10, 11, and 22, including the applicant’s attributable investors and affiliates, was required to have had gross revenues of less than \$125 million in each of the last two years and to have less than \$500 million in total assets at the short-form filing deadline. See Implementation of Section 309(j) of the Communications Act – Competitive Bidding, PP Docket 93-253, *Fifth Report and Order*, 9 FCC Rcd 5532, 5581-82, ¶ 115 (1994) (“*Competitive Bidding Fifth Report and Order*”); 47 C.F.R. § 24.709. But see *id.* § 24.709(b)(9)(i) (grandfather exception).

¹² In Auction No. 35, the C and F block threshold eligibility requirement (*see supra* note 10) applied only to applicants participating in closed bidding. See Amendment of the Commission’s Rules Regarding Installment Payment Financing for Personal Communications Services (PCS) Licensees, *Sixth Report and Order and Order on Reconsideration*, 15 FCC Rcd. 16,266, 16,267-69, ¶2, 16,275-82, ¶¶16-29 (2000) (“*C and F Block Sixth Report and Order*”). Bidding credits in Auction No. 35, however, were available only to small businesses for licenses they had won in open bidding. See *id.*, 15 FCC Rcd. 16,267-69, ¶2, 16,287-88, ¶¶ 43-45. Accordingly, small business applicants did not have to meet the total assets test in order to participate in the auction. Nevertheless, two-thirds of those qualifying to bid on closed licenses in Auction No. 35 also qualified as small businesses. See *C and F Block Broadband PCS Auction Closes, Public Notice*, 16 FCC Rcd 2339 (2001).

¹³ Rulemaking to Amend Parts 1, 2, 21, and 25 of the Commission’s Rules to Redesignate the 27.5-29.5 GHz Frequency Band, to Reallocate the 29.5-30.0 GHz Frequency Band, to Establish Rules and Policies for Local Multipoint Distribution Service and for Fixed Satellite Services, Petitions for Reconsideration of the Commission’s Competitive Bidding Rules, CC Docket No. 92-297, *Second Order on Reconsideration*, 12 FCC Rcd 15082, 15096-97, ¶ 22 (1997) (Petitioners had sought an assets test whereby entities with assets exceeding a specific threshold would be excluded from eligibility for small business provisions.).

¹⁴ The U.S. Small Business Administration has indicated that it does not use an asset test in its small business size determinations. See letter from Jere W. Glover, Esq., Chief Counsel for Advocacy, and S. Jenell Trigg, Esq., Assistant Chief Counsel for Telecommunications, Office of Advocacy, U.S. Small Business Administration, to William E. Kennard, Chairman, Federal Communications Commission (Sept. 10, 1998).

standard of Section 1.2110 as its general attribution rule for all future auctions.¹⁵ For purposes of calculating equity held in an applicant or licensee, the controlling interest standard treats certain ownership agreements, such as warrants, stock options, convertible debentures, and agreements to merge, as already having been “fully diluted,” i.e., fully exercised.¹⁶ Under the broadband PCS attribution rule, the Commission established two exceptions to the fully diluted requirement, one for “rights of first refusal” and the other for “put” options.¹⁷ Under the exceptions, neither type of interest was attributed until its actual exercise. No similar exception was ever allowed for “call” options.¹⁸ The Commission explained in the context of the prior broadband PCS attribution rules that “calls” vest an impermissible degree of control in the applicant’s (or licensee’s) so-called noncontrolling investors, because “calls” can be used to force a designated entity to sell its ownership interests.¹⁹ In the *Further Notice*, the Commission sought comment on whether to incorporate into its Part 1 general competitive bidding rules exceptions to the fully diluted requirement for “rights of first refusal” and “put” options.²⁰

2. Discussion

5. We will adopt exceptions to the controlling interest standard’s fully diluted requirements for “rights of first refusal” and “put” options.²¹ The two exceptions are consistent with the Commission’s underlying goal of assuring that the decision of whether and when to transfer a license won by a designated entity rests with those in control of the designated entity.²² In deciding not to treat “rights of first refusal” as exercised when calculating ownership interests in the context of broadband PCS C and F block applications, the Commission reasoned that “[r]ights of first refusal differ from other types of options because they cannot be exercised unless there is a proposed sale to a third party” and that, even then, “it will still be the designated entity’s decision as to whether to sell the business.”²³ The

¹⁵ *Part 1 Fifth Report and Order*, 15 FCC Rcd 15,293, 15,323-27, ¶¶ 58-67.

¹⁶ *Further Notice*, 15 FCC Rcd 15,293, 15,332, ¶ 82; 47 C.F.R. § 1.2110(c)(2)(ii)(A); *see* § 24.709(b)(7). However, stock interests, such as stock options, convertible debentures, and agreements to merge, may not be used to appear to terminate or divest ownership interests before they actually do so. *See Further Notice*, 15 FCC Rcd 15,293, 15,332, n.248; *see also id.* §§ 1.2110(c)(5)(v), 24.709(b)(7).

¹⁷ Implementation of Section 309(j) of the Communications Act – Competitive Bidding, PP Docket No. 93-253, *Fifth Memorandum Opinion and Order*, 10 FCC Rcd 403, 454-56, ¶¶ 93-95 (1994) (“*Competitive Bidding Fifth Memorandum Opinion and Order*”). A “right of first refusal” is an agreement between parties that grants an investor the right to match a purchase offer from a third party. *See id.*, 10 FCC Rcd 455 n.220. A “put” option gives the holder of an ownership instrument the right to sell a share of stock at a specified price at any time up to the expiration date. *See id.* 10 FCC Rcd 454, ¶ 92.

¹⁸ A “call” option gives the holder the right to buy a share of stock at a specified price. *See id.*, 10 FCC Rcd 454, ¶ 92.

¹⁹ *See id.*, 10 FCC Rcd 454, ¶ 92, 455-56, ¶ 95. *See also C and F Block Sixth Report and Order*, 15 FCC Rcd. 16,290 n.150.

²⁰ *Further Notice*, 15 FCC Rcd 15,293, 15,332, ¶ 83.

²¹ No commenter addressed these exceptions.

²² *C and F Block Sixth Report and Order*, 15 FCC Rcd. 16,266, 16,290, ¶ 49.

²³ *See Competitive Bidding Fifth Memorandum Opinion and Order*, 10 FCC Rcd at 454-55, ¶ 94.

Commission used the same reasoning for “put” options, explaining that “[p]ut options held by the designated entity leave the ownership decision in the designated entity’s control and do not force an unwanted sale upon the designated entity.”²⁴ We believe that the Commission’s earlier reasoning is generally applicable under our Part 1 rules.²⁵

6. We make clear, however, that, while “rights of first refusal” and “put” options will not be factored in for purposes of determining *de jure* control, we will continue to look at whether these ownership interests in combination with other terms to an agreement deprive an otherwise qualified designated entity of *de facto* control of an applicant or licensee.²⁶ As the Commission stated in the *Competitive Bidding Fifth Memorandum Opinion and Order* with regard to broadband PCS, we will look at the totality of circumstances in each particular case.²⁷

B. Mutually Exclusive Contingent Ownership Interests

1. Background.

7. Under the Commission’s previous broadband PCS attribution rule, an interpretation of the fully diluted requirement was applied to contingent ownership interests that were mutually exclusive by their terms.²⁸ Under this interpretation, if an ownership interest by its terms was mutually exclusive of one or more other ownership interests, the various ownership interests were treated as having been fully

²⁴ See *id.*, 10 FCC Rcd at 455-56, ¶ 95.

²⁵ We also emphasize that under the controlling interest standard we continue to consider “call” options to be fully diluted (i.e., fully exercised). See *ClearComm, L.P. For Consent to Pro Forma Assignment to NewComm Wireless Services, Inc., of C Block Broadband PCS licenses for BTAs B488 and B489, Memorandum Opinion and Order*, DA 01-2421, at 15, ¶ 23 (AIAD, rel. Oct. 17, 2001) (“*ClearComm Order*”).

²⁶ See *Competitive Bidding Fifth Memorandum Opinion and Order*, 10 FCC Rcd at 455-56, ¶¶ 95-96 (“[A]greements between designated entities and strategic investors that involve terms (such as management contracts combined with rights of first refusal, loans, puts, etc.) that cumulatively are designed financially to force the designated entity into a sale (or major refinancing) will constitute a transfer of control under our rules.”). See also *In re Applications of AirGate Wireless, L.L.C., Assignor, and Cricket Holdings, Inc., Assignee and Application of Leap Wireless International, Inc., For Authorization to Construct and Operate 36 Broadband PCS C Block Licenses, Memorandum Opinion and Order*, 14 FCC Rcd 11,827, 11,836, ¶ 20 (CWD, 1999) (“*Leap Order*”), *aff’d*, 15 FCC Rcd 13,557 (2000); and *ClearComm Order*, DA 01-2421, at 15, ¶ 23:

“[O]wnership interests, such as “warrants” and “options,” and “calls” are calculated on a fully diluted basis because they can be used to force a designated entity to sell its ownership interests. Significantly, even provisions that ostensibly, in isolation, allow the designated entity to retain control over the decision whether to sell may also be treated as fully diluted when, in combination with other provisions that limit the designated entity’s rights, they divest the designated entity of control.”

²⁷ See *Competitive Bidding Fifth Memorandum Opinion and Order*, 10 FCC Rcd at 456, ¶ 96.

²⁸ See Letter from Amy J. Zoslov, Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, to Cheryl A. Tritt, Esq., and Michael K. Kurtis, Esq., counsel for DiGiPH PCS, Inc., 13 FCC Rcd 17,950, 17,952 (AIAD 1998) (“*DiGiPH Letter*”); see also *Leap Order*, 14 FCC Rcd at 11,838-39, ¶ 23, n.73.

exercised only in the possible combinations in which they could be exercised by their holder(s). In the *Further Notice*, the Commission tentatively concluded that the policy underlying its Part 1 attribution rule did not require it to consider all existing stock conversion rights as having been fully exercised simultaneously in a case where the various conversion rights are mutually exclusive by their terms.²⁹ The Commission sought comment on adopting this interpretation as an exception to its Part 1 general competitive bidding rules.³⁰

2. Discussion.

8. Rather than adopt an additional exception to the fully diluted requirement, we clarify that the interpretation that was applied in the broadband PCS context for contingent ownership interests that are mutually exclusive by their terms is generally applicable under our Part 1 rules.³¹ This clarification offers a common sense approach to evaluating ownership interests that could not possibly be given simultaneous or successive effect.³² Under the clarification, ownership interests that by their terms are capable of being exercised simultaneously or successively will continue to be treated as if the rights thereunder had been fully exercised. Ownership interests that are mutually exclusive by their terms will be considered to be fully diluted only in the possible combinations in which they could be exercised by their holder(s). Thus, in calculating the equity held in an applicant or licensee, we will consider the various combinations of stock options or conversion rights that could possibly be exercised by an investor. For each combination, the ownership interests will be considered to have been fully exercised, and each combination will be reviewed for its effect on control of the applicant or licensee. We will consider one contingent ownership interest to be mutually exclusive of another only if contractual language specifies that both interests cannot be held simultaneously as present ownership interests.³³

IV. PROCEDURAL MATTERS AND ORDERING CLAUSES

9. As required by the Regulatory Flexibility Act, 5 U.S.C. § 604, the Commission has prepared a Final Regulatory Flexibility Analysis, set forth below at Appendix C.

10. Accordingly, IT IS ORDERED that, pursuant to Sections 4(i), 5(b), 5(c)(1), 309(r), and 309(j) of the Communications Act of 1934, as amended, 47 U.S.C. Sections 154(i), 155(b), 156(c)(1), 303(r), and 309(j), this *Eighth Report and Order* is hereby ADOPTED, and Section 1.2110 of the Commission's rules, 47 C.F.R. Section 1.2110, is amended as set forth below in Appendix A, effective 30

²⁹ *Further Notice*, 15 FCC Rcd 15,293, 15,333, ¶¶ 86.

³⁰ *Id.*, 15 FCC Rcd 15,293, 15,332-34, ¶¶ 83-87.

³¹ No commenter addressed this proposal.

³² In light of existing precedent on contingent ownership interests, the adoption of a rule exception is unnecessary. Any interpretation other than the one we adopt today would be unnecessarily punitive and contrary to the rule's underlying purpose. When mutually exclusive contingent ownership interests cannot, by their own terms, be contemporaneously exercised, it would be unreasonable – and unfair to applicants and licensees – to consider those interests as simultaneously fully diluted. Moreover, our interpretation and clarification of the rule supports the goal of our attribution rule – to prevent larger entities from illegitimately seeking status as small businesses or entrepreneurs. *See Part 1 Fifth Report and Order*, 15 FCC Rcd 15,293, 15,325, ¶ 64.

³³ *See DiGiPH Letter*, 13 FCC Rcd 17,952.

days after publication in the Federal Register.

11. IT IS FURTHER ORDERED that the Commission's Consumer Information Bureau, Reference Information Center, SHALL SEND a copy of this *Eighth Report and Order*, including the Final Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

12. IT IS FURTHER ORDERED that, pursuant to 47 U.S.C. § 155(c) and 47 C.F.R. § 0.331, the Chief of the Wireless Telecommunications Bureau IS GRANTED DELEGATED AUTHORITY to prescribe and set forth procedures for the implementation of the provisions adopted herein.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton
Acting Secretary

APPENDIX A

Final Rules

Section 1.2110 of Part 1 of Title 47 of the Code of Federal Regulations is amended by revising paragraphs (c)(2)(ii)(A) and (c)(5)(v) to read as follows:

§ 1.2110 Designated entities.

* * * * *

(c) * * *

(1) * * *

(2) * * *

(i) * * *

(ii) * * *

(A) Fully diluted requirement. (1) Except as set forth in paragraph (c)(2)(ii)(A)(2) of this section, ownership interests shall be calculated on a fully diluted basis; all agreements such as warrants, stock options and convertible debentures will generally be treated as if the rights thereunder already have been fully exercised.

(2) Rights of first refusal and put options shall not be calculated on a fully diluted basis for purposes of determining *de jure* control; however, rights of first refusal and put options shall be calculated on a fully diluted basis if such ownership interests, in combination with other terms to an agreement, deprive an otherwise qualified applicant or licensee of *de facto* control.

* * * * *

(5) * * *

(i) * * *

(v) Affiliation arising under stock options, convertible debentures, and agreements to merge.

Except as set forth in paragraph (c)(2)(ii)(A)(2) of this section, stock options, convertible debentures, and

agreements to merge (including agreements in principle) are generally considered to have a present effect on the power to control the concern. Therefore, in making a size determination, such options, debentures, and agreements are generally treated as though the rights held thereunder had been exercised. However, an affiliate cannot use such options and debentures to appear to terminate its control over another concern before it actually does so.

Example 1. If company B holds an option to purchase a controlling interest in company A, who holds an attributable interest in a PCS application, the situation is treated as though company B had exercised its rights and had become owner of a controlling interest in company A. The gross revenues of company B must be taken into account in determining the size of the applicant.

* * * * *

NOTE TO PARAGRAPH (c)(2)(ii)(A): Mutually exclusive contingent ownership interests, i.e., one or more ownership interests that, by their terms, are mutually exclusive of one or more other ownership interests, shall be calculated as having been fully exercised only in the possible combinations in which they can be exercised by their holder(s). A contingent ownership interest is mutually exclusive of another only if contractual language specifies that both interests cannot be held simultaneously as present ownership interests.

NOTE TO PARAGRAPH (c)(5)(v): Mutually exclusive contingent ownership interests, i.e., one or more ownership interests that, by their terms, are mutually exclusive of one or more other ownership interests, shall be calculated as having been fully exercised only in the possible combinations in which they can be exercised by their holder(s). A contingent ownership interest is mutually exclusive of another only if contractual language specifies that both interests cannot be held simultaneously as present ownership interests.

APPENDIX B**Parties****Parties Filing Comments**

- Ventures in Paging, L.C., Conestoga Telephone and Telegraph Company, Penasco Valley, and Telephone Cooperative, Inc. (collectively “Joint Commenters”)
- National Telephone Cooperative Association (“NTCA”)
- Rural Telecommunications Group (“RTG”)
- Office of Advocacy, U.S. Small Business Administration (“SBA”)

Parties Filing *Ex Parte* Comments

- Ventures in Paging, L.C., Conestoga Telephone and Telegraph Company, Penasco Valley, Telephone Cooperative, Inc., and Souris River Telecommunications Cooperative (collectively “Joint Commenters”)

APPENDIX C

Final Regulatory Flexibility Analysis

1. As required by the Regulatory Flexibility Act (RFA),¹ an Initial Regulatory Flexibility Analysis (IRFA) was incorporated into the notice section of the *Fourth Further Notice of Proposed Rule Making* (“*Further Notice*”) in WT Docket No. 97-82.² The Commission sought written public comment on the proposals in the *Fourth Notice*, including comment on the IRFA.³

A. Need for, and Objectives of, This *Eighth Report and Order*.

2. This *Eighth Report and Order* resolves the proposals and tentative conclusions of the *Further Notice* concerning application of the controlling interest standard in determining eligibility for small business provisions in all services governed by our Part 1 rules. As stated in the *Further Notice*, the Commission’s objective is to ensure that its small business provisions are available only to bona fide small businesses.⁴ Accordingly, the Commission sought comment in the *Further Notice* on whether to incorporate a total assets component into its ownership attribution rule for determining which entities are eligible for small business provisions in competitive bidding proceedings.⁵ In this *Eighth Report and Order*, the Commission declines to incorporate a total assets test into its determinations of small business eligibility, deciding that the potential benefit from such a test does not justify the difficulty of its use. Instead, the Commission will continue to rely on the gross revenues test already employed. The Commission, however, adopts two exceptions to its ownership attribution rule requiring that certain ownership agreements, such as warrants and stock options, be treated as already having been “fully

¹ See 5 U.S.C. § 603. The RFA, *see* 5 U.S.C. § 601 *et seq.*, has been amended by the Contract With America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) (CWAAA). Title II of CWAAA is the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).

² Amendment of Part 1 of the Commission’s Rules -- Competitive Bidding Procedures, Allocation of Spectrum Below 5 GHz Transferred from Federal Government Use, 4660-4685 MHz, WT Docket No. 97-82, ET Docket No. 94-32, *Third Report and Order and Second Further Notice of Proposed Rule Making*, 13 FCC Rcd 374 (1997) (“*Part 1 Third Report and Order*” and “*Second Notice*”) (*see* IRFA at Appendix C).

³ See 5 U.S.C. § 604.

⁴ See Amendment of Part 1 of the Commission’s Rules – Competitive Bidding Procedures, WT Docket No. 97-82, *Order on Reconsideration of the Third Report and Order, Fifth Report and Order, and Fourth Further Notice of Proposed Rule Making* (in relevant part, “*Part 1 Fourth Further Notice of Proposed Rule Making*” or “*Further Notice*”), 15 FCC Rcd 15,293, 15,331-34, ¶¶ 79-88 (2000).

⁵ See *Further Notice*, 15 FCC Rcd 15,331-32, ¶¶ 80-81. See 47 C.F.R. § 1.2110(b)(1) (“The gross revenues of the applicant (or licensee), its controlling interests and their affiliates shall be attributed to the applicant and considered on a cumulative basis and aggregated for purposes of determining whether the applicant (or licensee) is eligible for status as a small business under this section.”) See also *id.* § 1.2110(c)(1) (“Small businesses. The Commission will establish the definition of a small business on a service-specific basis, taking into consideration the characteristics and capital requirements of the particular service.”)

diluted” (i.e., fully exercised) for purposes of determining small business eligibility in the competitive bidding context.⁶ The Commission determines that these two exceptions – for “rights of first refusal” and “put” options – are consistent with its goal that the competitive bidding attribution rules ensure that control of an applicant is held by eligible entities while allowing investment in the applicant by entities that do not meet the size restrictions in Commission rules.⁷ The Commission also decides to clarify its Part 1 rules regarding application of the fully diluted requirement to contingent ownership interests that are mutually exclusive by their terms. Under this clarification, if an ownership interest by its terms is mutually exclusive of one or more other ownership interests, the various ownership interests are treated as having been fully exercised only in the possible combinations in which they could be exercised by their holder(s). The Commission determines that this clarification offers a common sense approach to evaluating ownership interests that could not possibly be given simultaneous or successive effect.

B. Summary of Significant Issues Raised by Public Comments In Response to the IRFA.

3. No comments directly addressed the IRFA; however, all four comments addressed a single small business issue – whether the Commission should incorporate a total assets component into its ownership attribution rule for determining which entities are eligible for small business provisions in competitive bidding proceedings. Commenters favoring the inclusion of a total assets test suggest that it could serve to prevent low-revenue but asset-rich businesses from taking advantage of small business programs.⁸ However, others argue that a total assets test might disqualify small entities by setting an asset limit that is too low or by attributing assets that are not readily available to these entities for auction purposes.⁹ While the Commission believes that both arguments have merit, it also believes that its attribution rules effectively prevent most asset-rich applicants from taking advantage of its small business benefits. Our attribution rules already prevent many asset-rich applicants from taking advantage of our small business benefits, because, to the extent that their assets, or those of their controlling interests and affiliates, produce revenues, those revenues must be attributed to the applicant.¹⁰ Moreover, the

⁶ See 47 C.F.R. § 1.2110(c)(2)(ii)(A) and (5)(v).

⁷ See *Further Notice*, 15 FCC Rcd 15,333, ¶ 84. See also Implementation of Section 309(j) of the Communications Act – Competitive Bidding, PP Docket No. 93-253, *Fifth Memorandum Opinion and Order*, 10 FCC Rcd 403, 454-56, ¶¶ 93-95 (1994) (“*Competitive Bidding Fifth Memorandum Opinion and Order*”). A “right of first refusal” is an agreement between parties that grants an investor the right to match a purchase offer from a third party. See *id.*, 10 FCC Rcd 455 n.220. A “put” option gives the holder of an ownership instrument the right to sell a share of stock at a specified price at any time up to the expiration date. See *id.* 10 FCC Rcd 454, ¶ 92. See also Letter from Amy J. Zoslov, Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, to Cheryl A. Tritt, Esq., and Michael K. Kurtis, Esq., counsel for DiGiPH PCS, Inc., 13 FCC Rcd 17,950 (AIAD 1998); In re Applications of AirGate Wireless, L.L.C., Assignor, and Cricket Holdings, Inc., Assignee and Application of Leap Wireless International, Inc., For Authorization to Construct and Operate 36 Broadband PCS C Block Licenses, *Memorandum Opinion and Order*, 14 FCC Rcd 11,827, 11,836, ¶ 20 (CWD, 1999), *aff’d*, 15 FCC Rcd 13,557 (2000).

⁸ See NTCA Comments at 1-3, RTG Comments at 4-5, and SBA Comments at 2.

⁹ See Joint Commenters Comments at 3.

¹⁰ See 47 C.F.R. § 1.2110(b),(c).

Commission's experience in using a total assets test to determine C and F block entrepreneur eligibility indicates that the test adds complexity to business size determinations without producing a commensurate benefit. In broadband PCS Auctions No. 5, 10, 11, and 22, in which all C and F block bidders were required to meet a total assets test as well as a gross revenues test to establish entrepreneur eligibility,¹¹ more than 95 percent of those bidders also met the more stringent gross revenues test required for small business bidding credit eligibility.¹² Thus, in practice, having a total assets test for the C and F blocks has not made a significant difference in defining the qualified applicant population. At the same time, employing a total assets test carries administrative costs for the Commission and for applicants and raises difficult valuation issues. The Commission believes that the potential benefit provided by a total assets test does not outweigh the valuation difficulties and the administrative costs the test would impose. Moreover, the Commission is reluctant to impose an additional regulatory burden on spectrum auction applicants at a time when it is striving to deregulate and streamline Commission processes. For these reasons, the Commission will not implement a total assets test for small business eligibility determinations.

C. Description and Estimate of the Number of Small Entities to Which the Proposed Rules Will Apply.

4. The RFA directs agencies to provide a description of and, where feasible, an estimate of the number of small entities that may be affected by the proposed rules, if adopted.¹³ The RFA generally defines the term "small entity" as having the same meaning as the terms "small organization," "small business," and "small governmental jurisdiction."¹⁴ The term "small business" has the same meaning as the term "small business concern" under the Small Business Act.¹⁵ A small business concern is one which:

¹¹ An applicant for C and F block licenses in Auctions No. 5, 10, 11, and 22, including the applicant's attributable investors and affiliates, was required to have had gross revenues of less than \$125 million in each of the last two years and to have less than \$500 million in total assets at the short-form filing deadline. See Implementation of Section 309(j) of the Communications Act – Competitive Bidding, PP Docket 93-253, *Fifth Report and Order*, 9 FCC Rcd 5532, 5581-82, ¶ 115 (1994) ("Competitive Bidding Fifth Report and Order"); 47 C.F.R. § 24.709. But see *id.* § 24.709(b)(9)(i) (grandfather exception).

¹² In Auction No. 35, the C and F block threshold eligibility requirement (*see supra* note 10) applied only to applicants participating in closed bidding. See Amendment of the Commission's Rules Regarding Installment Payment Financing for Personal Communications Services (PCS) Licensees, *Sixth Report and Order and Order on Reconsideration*, 15 FCC Rcd. 16,266, 16,267-69, ¶¶ 2, 16,275-82, ¶¶ 16-29 (2000) ("C and F Block Sixth Report and Order"). Bidding credits in Auction No. 35, however, were available only to small businesses for licenses they had won in open bidding. See *id.*, 15 FCC Rcd. 16,267-69, ¶¶ 2, 16,287-88, ¶¶ 43-45. Accordingly, small business applicants did not have to meet the total assets test in order to participate in the auction. Nevertheless, two-thirds of those qualifying to bid on closed licenses in Auction No. 35 also qualified as small businesses. See C and F Block Broadband PCS Auction Closes, *Public Notice*, 16 FCC Rcd 2339 (2001).

¹³ 5 U.S.C. § 603(b)(3).

¹⁴ 5 U.S.C. § 601(6).

¹⁵ 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in 15 U.S.C. § 632). Pursuant to the RFA, the statutory definition of a small business applies "unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register." 5 U.S.C. § 601(3).

(1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the SBA. According to SBA reporting data, there were 4.44 million small business firms nationwide in 1992.¹⁶ A small organization is generally “any not-for-profit enterprise which is independently owned and operated and is not dominant in its field.”¹⁷ Nationwide, as of 1992, there were approximately 275,801 small organizations.¹⁸ “Small governmental jurisdiction” generally means “governments of cities, counties, towns, townships, villages, school districts, or special districts, with a population of less than 50,000.”¹⁹ As of 1992, there were approximately 85,006 such jurisdictions in the United States.²⁰ This number includes 38,978 counties, cities, and towns; of these, 37,566, or 96 percent, have populations of fewer than 50,000. The Census Bureau estimates that this ratio is approximately accurate for all governmental entities. Thus, of the 85,006 governmental entities, we estimate that 81,600 (91 percent) are small entities.

5. The amendments to Section 1.2110 adopted in this *Eighth Report and Order* will apply to all entities that apply to participate in Commission auctions, including small entities. The number of entities that may apply to participate in future Commission auctions is unknown. The number of small businesses that have participated in prior auctions has varied. In all of our auctions held to date except for the auctions for broadcast licenses, 1,513 out of a total of 1,881 qualified bidders have been small businesses as that term has been defined under rules adopted by the Commission for specific services.²¹ Given these statistics, we expect that, in the future, a large percentage of participants in our auctions program generally will continue to be small businesses; although, there may not be a large percentage in every auction.

D. Description of Reporting, Recordkeeping, and Other Compliance Requirements.

6. The rule changes established in the *Eighth Report and Order* do not alter reporting, recordkeeping, or other compliance requirements.

E. Steps Taken to Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered.

7. The RFA requires an agency to describe any significant alternatives that it has considered in reaching its proposed approach, which may include the following four alternatives (among others): (1) the establishment of differing compliance or reporting requirements or timetables that take into account the

¹⁶ 1992 Economic Census, U.S. Bureau of the Census, Table 6 (special tabulation of data under contract to Office of Advocacy of the U.S. Small Business Administration).

¹⁷ 5 U.S.C. § 601(4).

¹⁸ *See supra* note 45.

¹⁹ 5 U.S.C. § 601(5).

²⁰ 1992 Census of Governments, U.S. Bureau of the Census, U.S. Department of Commerce.

²¹ As provided in Section 1.2110(c)(1) of the Commission’s rules, and in conformity with the Small Business Act and the regulations of the Small Business Administration, the Commission establishes small business definitions for purposes of its auctions on a service-specific basis. *See* 47 C.F.R. § 1.2110(c)(1); 15 U.S.C. § 632(c)(2)(C); 13 C.F.R. § 121.902(b). *See also supra* note 44. Statistics for broadcast license auctions are not available.

resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule or any part thereof for small entities.²² In this *Eighth Report and Order*, the Commission considers the following issues, all of which concern how best to apply the Commission's ownership attribution rule in order to determine which entities are eligible for small business provisions in competitive bidding proceedings.

8. *Total assets test.* The Commission generally employs a gross revenues test to measure the size of an entity for competitive bidding purposes.²³ In the *Eighth Report and Order*, the Commission declines to add a total assets component to the existing gross revenues test in order to determine small business eligibility. While some commenters contend that the addition of a total assets test might help prevent low-revenue but asset-rich businesses from taking advantage of small business programs,²⁴ others argue that including a total assets test might disqualify small entities by setting an asset limit that is too low or by attributing assets that are not readily available to these entities for auction purposes.²⁵ In addition to a gross revenues test, the Commission currently employs a total assets test to evaluate the eligibility of applicants to acquire broadband Personal Communications Services (PCS) C and F block licenses made available in "closed" (entrepreneur-only) bidding.²⁶ The Commission's experience in using a total assets test for C and F block entrepreneur eligibility determinations suggests that the potential benefit derived from a total assets test is insufficient to justify the difficulty involved in its implementation. In broadband PCS Auctions No. 5, 10, 11, and 22, in which all C and F block bidders were required to meet a total assets test as well as a gross revenues test to establish entrepreneur eligibility,²⁷ more than 95 percent of those bidders also met the more stringent gross revenues test required for small business bidding credit eligibility.²⁸ Thus, in practice, having a total assets test for the

²² See 5 U.S.C. § 603.

²³ Amendment of Part 1 of the Commission's Rules – Competitive Bidding Procedures, Allocation of Spectrum Below 5 GHz Transferred from Federal Government Use, 4660-4685 MHz, WT Docket No. 97-82, ET Docket No. 94-32, *Third Report and Order and Second Further Notice of Proposed Rule Making*, 13 FCC Rcd 374, 388-89, ¶ 19 (1997) ("*Part 1 Third Report and Order*").

²⁴ See NTCA Comments at 1-3, RTG Comments at 4-5, and SBA Comments at 2.

²⁵ See Joint Commenters Comments at 3.

²⁶ See 47 C.F.R. § 24.720(b)(1) and (2).

²⁷ An applicant for C and F block licenses in Auctions No. 5, 10, 11, and 22, including the applicant's attributable investors and affiliates, was required to have had gross revenues of less than \$125 million in each of the last two years and to have less than \$500 million in total assets at the short-form filing deadline. See Implementation of Section 309(j) of the Communications Act – Competitive Bidding, PP Docket 93-253, *Fifth Report and Order*, 9 FCC Rcd 5532, 5581-82, ¶ 115 (1994) ("*Competitive Bidding Fifth Report and Order*"); 47 C.F.R. § 24.709. But see *id.* § 24.709(b)(9)(i) (grandfather exception).

²⁸ In Auction No. 35, the C and F block threshold eligibility requirement (see *supra* note 10) applied only to applicants participating in closed bidding. See Amendment of the Commission's Rules Regarding Installment Payment Financing for Personal Communications Services (PCS) Licensees, *Sixth Report and Order and Order on Reconsideration*, 15 FCC Rcd. 16,266, 16,267-69, ¶2, 16,275-82, ¶¶16-29 (2000) ("*C and F Block Sixth Report and Order*"). Bidding credits in Auction No. 35, however, were available only to small businesses for licenses they had won in open bidding. See *id.*, 15 FCC Rcd. 16,267-69, ¶2, 16,287-88, ¶¶ 43-45. Accordingly, small business applicants did not have to meet the total assets test in order to participate in the (continued....)

C and F blocks has not made a significant difference in defining the qualified applicant population. At the same time, employing a total assets test carries administrative costs for the Commission and for applicants and raises difficult valuation issues.²⁹ The Commission believes that the potential benefit provided by a total assets test does not outweigh the valuation difficulties and the administrative costs the test would impose.

9. *Attribution exceptions for “rights of first refusal” and “put” options.* The Commission adopts exceptions to the controlling interest standard’s fully diluted requirements for “rights of first refusal” and “put” options. The two exceptions are consistent with the Commission’s underlying goal of assuring that the decision of whether and when to transfer a license won by a designated entity rests with those in control of the designated entity.³⁰ Adoption of these exceptions should help the Commission realize its goal of widening the opportunities for small businesses in the spectrum auction program.

10. *Attribution clarification for mutually exclusive contingent ownership interests.* The Commission clarifies that the interpretation that was applied in the broadband PCS context for contingent ownership agreements that are mutually exclusive by their terms is generally applicable under its Part 1 rules. Under the clarification, ownership interests that by their terms are capable of being exercised simultaneously or successively will continue to be treated as if the rights thereunder had been fully exercised. Ownership interests that are mutually exclusive by their terms will be considered to be fully diluted only in the possible combinations in which they could be exercised by their holder(s). Applying this clarification provides a common sense approach to evaluating ownership interests that could not possibly be given simultaneous or successive effect and should further help the Commission realize its goal of widening the opportunities for small businesses in the spectrum auction program.³¹

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auction. Nevertheless, two-thirds of those qualifying to bid on closed licenses in Auction No. 35 also qualified as small businesses. See C and F Block Broadband PCS Auction Closes, *Public Notice*, 16 FCC Rcd 2339 (2001).

²⁹ As the Commission observed in its decision not to establish a total assets test for Local Multipoint Distribution Service business size determinations, “[a]ssets, being potentially fluid and subject to inconsistent valuation (e.g., intangibles) are generally much less ascertainable than gross revenues” Rulemaking to Amend Parts 1, 2, 21, and 25 of the Commission’s Rules to Redesignate the 27.5-29.5 GHz Frequency Band, to Reallocate the 29.5-30.0 GHz Frequency Band, to Establish Rules and Policies for Local Multipoint Distribution Service and for Fixed Satellite Services, Petitions for Reconsideration of the Commission’s Competitive Bidding Rules, CC Docket No. 92-297, *Second Order on Reconsideration*, 12 FCC Rcd 15,082, 15,096-97, ¶ 22 (1997) (Petitioners had sought an assets test whereby entities with assets exceeding a specific threshold would be excluded from eligibility for small business provisions.).

³⁰ *C and F Block Sixth Report and Order*, 15 FCC Rcd. 16,266, 16,290, ¶ 49.

³¹ In light of existing precedent on contingent ownership interests, the adoption of a rule exception is unnecessary. Any interpretation other than the one the Commission adopts today would be unnecessarily punitive and contrary to the rule’s underlying purpose. When mutually exclusive contingent ownership interests cannot, by their own terms, be contemporaneously exercised, it would be unreasonable – and unfair to applicants and licensees – to consider those interests as simultaneously fully diluted. Moreover, the Commission’s interpretation and clarification of the rule supports the goal of its attribution rule – to prevent larger entities from illegitimately seeking status as small businesses or entrepreneurs. See Amendment of Part 1 of the Commission’s Rules – Competitive Bidding Procedures, WT Docket No. 97-82, *Order on Reconsideration of the Third Report and Order, Fifth Report and Order, and Fourth Further Notice of Proposed Rule Making*, 15 FCC Rcd 15,293, 15,325, ¶ 64 (2000).

F. Report to Congress.

11. The Commission will send a copy of this *Eighth Report and Order*, including this FRFA, in a report to Congress pursuant to the Small Business Regulatory Enforcement Fairness Act of 1996.³² This *Eighth Report and Order* and this FRFA (or summaries thereof) will also be published in the Federal Register³³ and will be sent to the Chief Counsel for Advocacy of the Small Business Administration.

³² 5 U.S.C. § 801(a)(1)(A).

³³ See 5 U.S.C. § 604(b).